No. 9413

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CHARLES LAUGHTON,

Respondent.

BRIEF OF RESPONDENT.

CLAUDE I. PARKER,
JOHN B. MILLIKEN,
808 Bank of America Building, Los Angeles,

LOYD WRIGHT,
HERSCHEL B. GREEN,
1125 Board of Trade Building, Los Angeles,

HARRIET GEARY,
808 Bank of America Building, Los Angeles,

Attorneys for Respondent.

Parker & Baird Company, Law Printers, Los Angeles.

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES. PAGE

STATUTES.

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Opinion Below.

The opinion of the United States Board of Tax Appeals was promulgated on June 15, 1939, is set forth in the record herein [R. 21-33] and is reported in 40 B. T. A. 101.

Jurisdiction.

In this appeal, petitioner, the Commissioner of Internal Revenue, seeks review of the decision of the United States Board of Tax Appeals entered September 11, 1939 [R. 33-34], pursuant to sections 1141 and 1142 of the Internal Revenue Code. Petition for Review was filed November 28, 1939.

Question Presented.

Whether the separate entity of a corporation organized for and engaged in the business of motion picture production should be disregarded and amounts earned by it as the result of advantageous contracts made with other studios for the loan of the services of a motion picture actor with whom it had a long term exclusive service contract should be considered as taxable to the individual rather than the corporation.

Statement of Case.

Petitioner adopts as his statement of the case in his opening brief the Findings of Fact made by the Board Member [R. 22-29] (Pet. Br. 2-8). Since in his assignment of errors [R. 38-41], his Statement of Points [R. 397-399] and his Statement of Points to be urged, incorporated in his brief (Pet. Br. 8-9), petitioner apparently challenges some of these findings of the Board, respondent here restates the facts in this case, giving in addition to the findings of the Board a summary of the evidence upon which these findings were based.

Based on the Stipulation of Facts entered into by the parties [R. 87], the Board found that the taxpayer, Charles Laughton, is a motion picture actor well known in both Great Britain and the United States. At all times pertinent to this proceeding he was a subject of Great Britain and a resident of and domiciled in England. [R. 23.]

The undisputed testimony of Mr. Alfred Tregear Chenhalls, experience chartered accountant [R. 49], member of the Board of Directors of Motion Picture and

Theatrical Industries, Ltd., since 1936 [R. 58] and personal friend and financial adviser of Mr. Laughton since before 1933 [R. 49, 67] discloses that Mr. Laughton's successes in light of the tax years here in question, namely, 1934 and 1935 were very recent, it being only in 1932 that he made his first film from which he derived money. [R. 49.]

Also from the testimony of Mr. Chenhalls [R. 77], the Board found that on May 4, 1932, the taxpayer executed a five-year contract with Frank Joyce-Myron Selznick, Ltd., which authorized them to act as his manager and personal representative. [R. 23.] Based on the Stipulation of Facts [R. 87], it was found that during 1932, Mr. Laughton came to the United States and was engaged in making four pictures for the Paramount-Publix Corporation, predecessor of Paramount Productions, Inc. He also made one picture for the Universal Pictures Corporation during 1932 under a loan of his services by Paramount-Publix to Universal. [R. 23.]

Again following the stipulation [R. 87-88] the Member found that on March 29, 1933, Mr. Laughton entered into a contract with Paramount Productions, Inc., hereinafter referred to as Paramount, under the terms of which one picture, "WHITE WOMAN," was produced in that year. Paragraph Twelfth of said contract provided in part as follows:

> "The Artist hereby grants to the Corporation an option upon the Artist's exclusive services in one (1) motion picture photoplay to be produced between April 15, 1934, and September 15, 1934, at the salary and at the rate of Three Thousand ($3,000.00) Dollars per week for not less than five (5) weeks for his services in such production."

Under date of September 15, 1933, Paramount notified respondent that it elected to exercise the foregoing option. [R. 23.]

Further substantially in the language of the Stipulation [R. 89] it was found that after completing the picture "WHITE WOMAN" respondent returned to England, and on April 30, 1934, a corporation bearing the name of "Motion Picture and Theatrical Industries, Limited," hereinafter referred to as Industries, Ltd., was organized under and by virtue of the laws of Great Britain, and specifically under the English Companies' Act of 1929. As set forth in its memorandum of association, the objects for which the company was established were to engage in the motion picture and theatrical businesses or any business incidental or related thereto. The principal place of business of Industries, Ltd., has been at all times since its formation and now is London, England. [R. 24.]

From the testimony of Mr. Chenhalls [R. 63, 64] the Board found that during the taxable years Industries, Ltd., was managed by a board of directors composed of business men. Mr. Laughton was not a member of the board of directors nor was he an officer of the company although he was the real beneficial owner of all its outstanding stock except qualifying shares for which he paid into the company £6000 or approximately $30,000.00. [R. 24.] Amplifying this finding of the Board from testimony of Mr. Chenhalls, it appears that the directors were not only allowed a free hand in running the corporation but that they never asked Mr. Laughton's permission; they were business men just as he was an actor. [R. 64.]

Returning again to the stipulation as a basis for its findings [R. 89], the Board states that on May 4, 1934. Mr. Laughton and Industries, Ltd., executed a contract

in London whereby in return for the payment of £150 or approximately $750.00 per week for the next five years thereafter, together with the payment of certain other expenses, Mr. Laughton agreed to give his sole and exclusive services to Industries, Ltd., subject always to the primary obligations of a contract entered into February 26, 1934, and then existing between him and London Film Productions, Ltd., whereby he was to make three pictures for the latter company. [R. 24, 25.]

Based on the copy of the contract entered into between Mr. Laughton and Industries, Ltd., which was attached to the Stipulation of Facts as Exhibit D, the Board found that respondent agreed to assign the profits and any moneys arising from the latter agreement and his right to ten per cent of the gross royalties from the photoplay "THE PRIVATE LIFE OF HENRY VIII" to Industries, Ltd., as part of the consideration for the contract of May 4, 1934. [R. 114.] Industries, Ltd., agreed to assume the obligation of respondent under his contract of May 4, 1932, with Frank Joyce-Myron Selznick, Ltd. [R. 117.] Paragraph 15 of respondent's agreement with Industries, Ltd., provided as follows:

> "15. Nothing in this agreement shall be contrary to the proposition that from time to time it is contemplated that the Employer itself will be engaging in motion picture or theatrical activities in the British Isles in connection with which it shall employ the Employee and in no case will it engage in any motion picture or theatrical activities in which there shall be a male principal part without employing the Employee in the enactment thereof unless the Employee expressly and in writing shall assent to the Employer in any such activities employing some other actor." [R. 115, R. 25.]

Pursuant to oral stipulation in open Court [R. 79] the Board found that on May 5, 1934, Mr. Laughton sailed for the United States. On May 14th he reached Los Angeles and commenced work as an actor in "THE BARRETTS OF WIMPOLE STREET" for Metro-Goldwyn-Mayer under a pending loan agreement which was finally executed between Metro-Goldwyn-Mayer and Industries, Ltd., on July 6, 1934. [R. 25, 26, 79, 92.] The agreement became effective as of May 14, 1934, provided for Mr. Laughton's appearance in "THE BARRETTS OF WIMPOLE STREET" and "MARIE ANTOINETTE" and permitted him to appear in one photoplay for Paramount. [R. 26, 145, *et seq.*] From the written stipulation [R. 91], the Board found that on July 5, 1934, the contract of March 29, 1933, between Mr. Laughton and Paramount was cancelled by mutual consent and on the same day Industries, Ltd., entered into an agreement with Paramount relative to the services of Mr. Laughton. This contract and the contract of Industries, Ltd., with Metro-Goldwyn-Mayer were both acknowledged by Mr. Laughton in a separate writing attached to each contract wherein he obligated himself individually to render the services agreed upon by the studios and Industries, Ltd. [R. 26, 144, 145, 169 to 172.] Subsequent contracts and modifications of existing contracts for the loan of Laughton's services by Industries, Ltd., were likewise acknowledged by respondent. [R. 26.] Based on the stipulation [R. 93] and testimony of Mr. Chenhalls, the Board found that under the loan agreement with Paramount, Mr. Laughton performed in "RUGGLES OF RED GAP" and Paramount paid Industries, Ltd., for such services the sum of $48,000.00 in 1934 and $6,000.00 in 1935. [R. 26, 93.] On December 21, 1934, Industries, Ltd., contracted for the loan of

Laughton's services to Twentieth Century Pictures, Inc. During 1935 Industries, Ltd., received $65,000.00 from Twentieth Century Pictures, Inc., for the services rendered the latter company by respondent. [R. 27, 93.]

Based upon the stipulation [R. 94] it was found that each of the three studios aforementioned deducted and withheld from the amounts that were paid to Industries, Ltd., the sums prescribed as income tax to be withheld at the source under the provisions of section 144, Revenue Act of 1934. The sums so deducted were paid to the Collector of Internal Revenue by the studios in the amounts and for the years as follows:

	1934	1935
Metro-Goldwyn-Mayer	$6,233.33	$16,394.24
Paramount Productions, Inc.	6,600.00	825.00
Twentieth Century Pictures, Inc.	–	8,937.50
Total	$12,833.33	$26,156.74

From the exhibits offered by the respondent (petitioner below) and admitted by the Board numbered 4 to 6, inclusive [R. 263-284], it was found that Industries. Ltd., filed its federal corporation income and excess profits tax returns for 1934 and 1935 showing net income of $46,-255.60 and $143,618.53 for 1934 and 1935, respectively. As to each year the return shows that the income tax due was less than the amount withheld by the studios. The overpayment shown on each return amounted to $6,473.18 for 1934 and $6,409.19 for 1935. [R. 27.] Again from the exhibits admitted into evidence numbered 7 to 11, inclusive [R. 285-293], the Board found that Industries, Ltd., filed capital stock tax returns for the fiscal years ended June 30, 1934, 1935 and 1936 and claimed exemp-

tion from payment of the capital stock tax. It appears from the affidavit attached to said capital stock tax returns that the ground upon which exemption was claimed from capital stock tax was that Industries, Ltd., was not doing business in the United States. [R. 287.] As the claimed exemption was denied, Industries, Ltd., paid a capital stock tax for each of the years. [R. 27, 28.]

Respondent's Exhibits 1 to 3, inclusive [R. 238-261], form the basis for the finding that respondent reported the salary he received from Industries, Ltd., for the taxable years 1934 and 1935 amounting to $32,811.66 and $22,419.09, respectively, and paid the income tax due thereon to the federal government and paid an income tax to the State of California for the year 1935. [R. 28.]

Respondent's Exhibits 9, 10 and 11 [R. 294-300], form the basis for the finding that Industries, Ltd., filed claims for refund for the amount of tax withheld by the studios over and above the amount shown as due on its income tax returns for 1934 and 1935. Additional claims for refund were filed by Industries, Ltd., for the refund of all the corporation's income tax withheld from it and paid to the collector by the studios in order to protect the corporation's interest in the event that this proceeding should result in the taxation of income to respondent. [R. 28.] Claims for refund were also filed for the capital stock tax paid for the fiscal years. [R. 303-308.] Claims for refund of the capital stock tax paid show that such claims were made for the reason that the Commissioner of Internal Revenue was proposing to assess income tax against respondent here disregarding the corporate entity. Such claims were, therefore, merely protective claims filed after the commencement of this proceeding. [R. 304, 306, 308.] Subsequent to the taxable years and in 1937, the

Bureau of Internal Revenue denied the claims for refund as to capital stock tax. The letter of the Commissioner denying these claims and on which the Board's finding to the above effect was based is set forth in the record in full. [R. 309-311.]

Reverting again to the testimony of Mr. Chenhalls, it was found that during the first year of its existence, May 1, 1934, to April 30, 1935, Industries, Ltd., loaned respondent $22,520.00 and during the second year it made additional loans to respondent amounting to $78,625.00. [R. 28, 74.] The loans in the first year were made because of the extra expenses occasioned to Mr. Laughton of maintaining living quarters in Hollywood and London simultaneously. [R. 28, 29, 74.] The loans made in the second year were nearly all spent in the purchase of a leasehold in London and a valuable painting. [R. 29, 74.] These loans were amply secured by the assignment of life insurance policies on Mr. Laughton's life amounting to $100,000.00 and by the leasehold. [R. 29, 74, 75.]

From the testimony of Mr. Chenhalls [R. 51, 52], from the minutes of the meetings of the directors of Industries, Ltd. [R. 316 to 373], the Board Member made his finding to the effect that Industries, Ltd., was organized for a business purpose. During the taxable years the company began gathering material and preparing for future production. In December, 1935, it acquired an option on a play called "THE FIRST GENTLEMAN." It did not begin production of pictures in the taxable years on account of lack of funds. Subsequent to the taxable years and after the company had accumulated sufficient capital, it actively engaged in production, either on its own account or through a subsidiary company. [R. 29.]

Summary of Argument.

1. The authorities upon which petitioner relies in support of his contentions are all cases in which there was a finding or conclusion that the diversion of income from the individual taxpayer to the corporate or other tax paying entity came about as a tax avoidance scheme or plan. Such authorities are inapplicable to the case at bar.

2. In an attempt to bring the case at bar within the cases cited by him, petitioner in support of his contentions has interpreted the facts in this case in a manner unwarranted both from the findings of fact of the Board of Tax Appeals and the evidence upon which such findings are based.

3. The contention of petitioner that the corporate entity of Industries, Ltd., should be disregarded and the income realized by it declared taxable to Mr. Laughton is contrary to the law as established by the Supreme Court and followed in the lower Courts.

ARGUMENT.

1. The Authorities Upon Which Petitioner Relies in Support of His Contentions Are All Cases in Which There Was a Finding or Conclusion That the Diversion of Income From the Individual Taxpayer to the Corporate or Other Tax Paying Entity Came About as a Tax Avoidance Scheme or Plan. Such Authorities Are Inapplicable to the Case at Bar.

From petitioner's citation on page 16 of his brief of the leading case of *New Colonial Ice Co. v. Helvering,* 292 U. S. 435, 54 S. Ct. 208, 78 L. Ed. 138, it appears that petitioner and respondent are in agreement upon the fundamental principle of law to the effect that the entity of a corporation as separate and distinct from its stockholders may—"be disregarded only in exceptional situations where it otherwise would present an obstacle to the protection or enforcement of public or private rights." 292 U. S. 435, 442. This rule has also been stated as follows:

> "However when courts of equity have invoked this principle (disregard of corporate entity) they have done so in general to prevent the use of the corporation by individuals or another corporation or corporations to perpetrate a fraud or to do injustice." (Matter in parentheses added.)
>
> *Dwyer v. Commissioner,* 18 B. T. A. 349, 352.

The following cases upon which petitioner largely relies in his brief in support of his contentions are not cases in which the above stated rule has been abrogated but rather are they cases in which that exceptional situation calling for the disregard of the corporate entity was present in

the facts appearing of record. In *Griffiths v. Helvering* (1940 Prentice-Hall, par. 62,010), cited on page 16 of petitioner's brief, the following facts appeared. In 1926 Griffiths paid one Lay $100,000.00 for some stock. The investment was unprofitable and Griffiths claimed and was allowed a deductible loss in his income tax return for the year 1931 of $92,500.00 resulting from a sale of the stock in that year to a wholly owned corporation. Thereafter in 1932 Griffiths realized that he had been defrauded by Lay in the 1926 purchase. Negotiations were begun for a settlement of his claim against Lay and by January, 1933, Griffiths' lawyer had arranged a settlement whereby Griffiths was to reacquire the shares from his wholly owned corporation to which he had sold them in 1921 and to convey them to another wholly owned corporation newly created for the purpose of furthering the scheme, which second wholly owned corporation, in turn, was to transfer the stock back to Lay for $100,000.00 to be paid by him. That sum was to be paid over by the corporation to Griffiths in annual installments for forty years with interest on the deferred payments. The scheme was carried out and the Court holds that the corporate entity of Griffiths' corporation should be disregarded and the sum received from Lay should be taxed to Griffiths as income, since prior to that time and for the year 1931 the Commissioner had allowed Griffiths a loss on the sale of the stock. In deciding the case the Court states:

> "A claim having been recognized by Lay and cast into a form realizable by Griffiths, a lawyer's ingenuity devised a technically elegant arrangement

> whereby an intricate outward appearance was given to the simple sale from Griffiths to Lay and the passage of money from Lay to Griffiths."

It is submitted that the case of *Griffiths v. Helvering, supra,* does not constitute authority in favor of the petitioner. The Court in that case from the facts of record there found that the diversion of income was the result of a tax avoidance scheme. It appeared nowhere in the facts that Griffiths' newly formed corporation had any purpose other than to receive the payments from Lay on the fraud claim which Griffiths had against Lay. It had no business purpose. It was only a shell conceived for a single purpose of deflecting income from Griffiths and to cause the latter to have a nominal income for the next forty years.

In contrast, in the case at bar the Board has found that Industries, Ltd., the motion picture production corporation organized by Mr. Laughton on April 30, 1934, was organized for a business purpose. During the taxable years the company began gathering material and preparing for future production. In December, 1935, it acquired an option on a play called "THE FIRST GENTLEMAN." It did not begin production of pictures in the taxable years on account of lack of funds. Subsequent to the taxable years and after the company had accumulated sufficient capital, it actively engaged in production either on its own account or through a subsidiary company. [R. 29.] This is a finding of fact of the Board of Tax Appeals from the evidence which was before it. Being a finding of fact

which the Board had power to make, it cannot now be challenged in this Court unless this Court in its investigation of the record determines that such finding is unsupported by any substantial evidence.

Palmer v. Commissioner, 302 U. S. 63, 58 Sup. Ct. 67, 82 L. Ed. 50 (1937);

Beech v. Commissioner, 82 Fed. (2d) 42 (C. C. A. 3d, 1936);

Commissioner v. DeMille Productions, 90 Fed. (2d) 12 (C. C. A. 9th, 1937);

Doernbecher Mfg. Co. v. Commissioner, 80 Fed. (2d) 573 (C. C. A. 9th, 1935);

Olympia Harbor Lumber Co. v. Commissioner, 79 Fed. (2d) 394 (C. C. A. 9th, 1935).

Petitioner has not attempted to argue that this finding is unsupported by the evidence, probably because the record is replete with uncontradicted testimony and documentary evidence supporting such finding. For instance, the testimony of Mr. Chenhalls [R. 50, 51], with regard to the formation of Industries, Ltd., is as follows:

> "Mr. Laughton used to talk to me about it continually * * * and he told me it was his theory that as an actor he would die poor. He had a Gerald DuMaurier in mind who died poor and he said that he was determined while he was on the crest of the wave to safeguard his resources, that he would engage the services of the finest writers in New York and technicians and cameramen and form a renaissance of the British film industry. It was a matter of common knowledge that the industry in England was at a low ebb. A few years later it crashed. All this he told me countless times. He figured that if

> anything went wrong with him, if he had any adverse experiences in an action at law or in case of fire or anything like that, everything could be taken. It is the normal course in England to form a corporation. He did it for that purpose. He had no idea of evading American taxes or English taxes. These discussions took place before, continually, for over two years before the organization of the corporation."

Petitioner in his brief (page 14) asserts—"that a close parallel between the situation in the instant case and that which obtained in *Jones v. Page,* 102 Fed. (2d) 144 (C. C. A. 5th) exists." It is submitted that an analysis of the facts in the above case shows that such a parallel does not exist. It appears from the findings of the District Court (22 A. F. T. R. 1287, 1938 Prentice-Hall, Par. 5.236) as follows: Prior to the contracting of his services to his father, Jones had entered into the contract from which the income in question was derived. After receiving the initial payment of $20,000.00 on his contract with Warner Brothers and actually commencing upon the enactment of the first picture, the Court finds as a fact that:

> "* * * plaintiff not having thought of the matter before, became aware that a substantial federal income tax burden would be imposed upon the earnings from his personal services under this contract. To avoid such a burden, plaintiff consulted tax counsel * * *."

Subsequently, after some negotiations between tax counsel and plaintiff's father, a contract was entered into whereby plaintiff agreed to perform for his father the identical services which he had already previously ex-

clusively agreed to perform and was in the midst of performing for Warner Brothers and gave his father authorization on his behalf to cancel any contracts then outstanding in his name. The original Warner Brothers contract was thereupon cancelled and a new contract was made with plaintiff's father as a party thereto. After receiving the proceeds derived from such contracts, plaintiff's father paid them into trust funds for the children of plaintiff and did not retain any of them. Thus it appears that with such a record before it, the Circuit Court in the *Jones* case was confronted with a clear scheme to avoid tax and the Circuit Court was correct in applying the rule of disregard of contractual arrangements in this exceptional situation.

Not only is the *Jones* case distinguishable, therefore, from the case at bar on the theory that the facts therein indicate a tax avoidance scheme or plan, a fact which was expressly negatived by the evidence in the case at bar [R. 51, 68] but also under the facts existing in the *Jones* case the income would be taxable to plaintiff Jones on another ground since under the purported trusts the money was to be used to fulfill Jones' own obligation, that of education, maintenance and support of his minor children. *Cf. Douglas v. Willcuts,* 296 U. S. 11, 56 Sup. Ct. 59, 80 L. Ed. 1 (1935). It is significant that at no time did Jones' father assert any beneficial interest to the income in question in that case. In the case at bar on the other hand, Industries, Ltd., has at all times not only received but asserted its beneficial interest in all sums received by it from its contracts from American producers. Furthermore, it was a business corporation with a business purpose in which said funds were employed and used for business expenditures.

As one feature of the parallelism between the *Jones* case and the case at bar, petitioner asserts that—"In each case the amount for which taxpayer sold his services was grossly inadequate." (Pet. Br. p. 15.) Respondent agrees with petitioner that the sum for which Jones sold his services to his father was grossly inadequate. In the words of the Circuit Court—"It would be absurd to say that any reasonable man having a contract from which he was to receive a minimum of $100,000 would in good faith transfer it to another for merely $6,000." However, in the instant case respondent cannot agree with petitioner that the sum for which Mr. Laughton agreed to render his services exclusively to Industries, Ltd., for a period of five years was grossly inadequate. As the basis for his conclusion, petitioner asserts that Mr. Laughton had very good reason to believe he could get about $3,000.00 per week from American producers and, in fact, had a contract to make one picture at that salary. It must be remembered that the salary of $3,000.00 per week which he might have obtained from American producers was to be paid only during the weeks in which he was employed by the producers. On the other hand the obligation of Industries, Ltd., to pay Mr. Laughton $750.00 per week was a continuing one to be paid week in and week out whether or not he was working either under loan agreements or directly for Industries, Ltd., and had to be paid for a period of five years.

In contrast with the fact that Mr. Jones, knowing that he would receive not less than $100,000, sold his services to his father for $6,000.00, are the facts shown in the case at bar wherein Mr. Laughton entered into an exclusive contract with Industries, Ltd., under the terms of which it was provided that there should be paid to him

over a period of five years at least the total sum of $195,000.00. Also despite the assertion of petitioner that his services could assuredly command large sums of money from American producers, there was in fact no such assurance when respondent and Industries, Ltd., executed the exclusive service contract during the year 1934. True it was contemplated that Mr. Laughton should come to America to render services for an American studio under a loan thereof from Industries, Ltd., at the probable rate of $3,000 per week to be paid to Industries, Ltd. However, had this one picture which was contemplated when Mr. Laughton left England been a failure, Industries, Ltd., would no doubt have been unable to obtain any more advantageous loan agreements with other American studios. The record shows that the loan contract with Twentieth Century Fox was entered into in December, 1934. Doubtless if the "BARRETTS OF WIMPOLE STREET" had happened to be a poor rather than a good picture this contract could not have been negotiated by Industries, Ltd. It is submitted, therefore, that neither on the facts nor on the law is *Jones v. Page, supra,* an authority upholding petitioner's contentions in the case at bar.

Petitioner next asserts (Pet. Br. p. 19) that the case of *Saenger v. Commissioner,* 69 Fed. (2d) 631, C. C. A. 5th (1934), is a case squarely in point to the effect that money earned and paid exclusively for the personal services of the taxpayer should be taxed to him notwithstanding the finding that Industries, Ltd., was organized for a business purpose. To this respondent replies that petitioner in order to find this case applicable must neces-

sarily misconceive the facts or the legal principle applicable in the case at bar. The *Saenger* case was a clear case in which a corporation awarded extra compensation to the taxpayer Saenger which he in turn assigned to another corporation. The fact that his assignment was made prior to the award of the compensation would not relieve taxpayer Saenger of the tax upon the compensation awarded to him because of the fact that it must necessarily have come to him in payment for services before the assignment by him could become operative. The *Saenger* case is clearly a case in which the rule of the United States Supreme Court in *Lucas v. Earl,* 281 U. S. 111, 50 Sup. Ct. 241, 74 L. Ed. 731 (1930), is applicable and, in fact, was decided on the authority of that case. In the case at bar, however, as it is stated by the Board Member in his opinion below—"There was no assignment of future earnings or future income such as existed in *Lucas v. Earl,* 281 U. S. 111, and there is here no occasion to apply the doctrine of that case." In the case at bar the consideration received by Industries, Ltd., for the loan of respondent's services was at no time due to be paid to respondent. In fact, the situation was, as the Board Member recognized, the common one in which one motion picture studio having no present vehicle or use for its contract player, loans the services of that player to another studio and receives the consideration for such loan, meanwhile continuing payments of salary under its original contract to the player. It is believed that there is no justification in petitioner's attempt to tax these payments to Mr. Laughton as income merely because of the stock ownership of this corporation when it has been proved and found that the corporation was a motion picture production corporation with business purposes just like any other studio.

2. **In An Attempt to Bring the Case at Bar Within the Cases Cited by Him Petitioner in Support of His Contentions Has Interpreted the Facts in This Case in a Manner Unwarranted Both From the Findings of Fact of the Board of Tax Appeals and the Evidence Upon Which Such Findings Are Based.**

Petitioner in his brief makes the following conclusion (Pet. Br. p. 20):

> "In the instant case even assuming that Industries, Ltd., was created for the business purpose of engaging in production on its own account as found by the Board, it is nevertheless apparent that it did not earn any part of the income in question nor contributed to it in any way nor did it serve any business function whatever relating to such income. In this connection it is significant that although the Board found that Industries, Ltd., was organized for the purpose of engaging in production, the Board made no finding that Industries, Ltd., was organized for or in fact performed any business function in connection with the sale of taxpayer's services to the American producers * * *."

In this conclusion petitioner apparently overlooked the facts found by the Board to the effect that all of the loan contracts were negotiated by Industries, Ltd., and the American Studios. [R. 26, 27.] Also petitioner apparently overlooked the evidence presented by the record which shows that all of these contracts were negotiated by the attorney-in-fact for Industries, Ltd., and to whom Industries, Ltd., paid the sum of $8,000.00 for his services

in carrying on the actual negotiations in the drafting of the loan contracts. [R. 74, 95.] Furthermore, the stipulation of facts shows that the attorney-in-fact for Industries, Ltd., was not the attorney for respondent until February 19, 1935, at which time all of the contracts for the services of respondent had been entered into.

It is peculiar that petitioner should make the above quoted assertion in this proceeding when in the past he has taken a diametrically opposite position with regard to Industries, Ltd. As is shown by the record, Industries, Ltd., filed protective claims for refund for capital stock tax paid by it for the fiscal years ended June 30, 1934, 1935 and 1936. [R. 28.] The ground stated for the refund of such capital stock tax on the claims filed was that since petitioner was asserting that liability for the sums paid to Industries, Ltd., by the American studios constituted the income of Mr. Laughton personally, rather than of Industries, Ltd., Industries, Ltd., therefore could not be said to be doing business within the meaning of the capital Stock Tax Act. In denying the claims for refund of capital stock tax, petitioner himself makes the following statement [R. 310, 311]:

> "The evidence of record discloses that the corporation was organized under the laws of Great Britain on April 30, 1934. Under date of May 4, 1934, Mr. Charles Laughton entered into a contract with Motion Picture and Theatrical Industries, Ltd., under which that company was to have the exclusive right to sublicense and loan his services for a period of five years at a stipulated weekly salary. Under the terms of this

agreement the corporation is entitled to all of Mr. Laughton's earnings after the date of the contract. Thereafter the corporation entered into contracts with certain American companies for the services of Mr. Laughton and collected the amounts payable thereunder. It also paid the stipulated salary of Mr. Laughton, agent's commission on the basis of 10 per cent of the gross income, and other miscellaneous expenses. In the year 1934 the gross income under the various contracts from sources within the United States amounted to $93,333.33, and in 1935 it amounted to $238,370.18. The corporation also maintained an agent in California for the purpose of conducting its United States business.

"The capital stock tax is an excise tax imposed upon foreign corporations with respect to carrying on or doing business within the United States. The tax is imposed upon the exercise of the privilege of doing business in a corporate form. Ordinarily the same activities which would subject a domestic corporation to the tax will also subject a foreign corporation to the tax.

"The activities referred to above clearly constitute carrying on or doing business within the United States during the years ended June 30, 1934, June 30, 1935, and June 30, 1936 * * *."

How petitioner can assert that Industries, Ltd., was not engaged in business for income tax purposes but miraculously clothes that corporation with an entity which

was doing business in the United States in corporate form for capital stock tax purposes is difficult to see.

Petitioner in his brief on page 21 goes on to state:

> "On the facts of record, the conclusion is inescapable that the taxpayer could have obtained precisely the same employment and at precisely the same terms had he continued to deal directly with the producers without employing Industries, Ltd., as an intermediary."

In the first place this statement makes an unwarranted assumption to the effect that the taxpayer did employ Industries, Ltd., as an intermediary. The evidence in this proceeding is completely contrary to the above assumption. The facts show that for over two years respondent had in mind going into the production end of the motion picture business. [R. 51, 52.] When Industries, Ltd., was finally formed and it appeared to the business men who were the directors of it that production could not be undertaken with the then existing capital condition of the corporation, it was necessary in order to preserve what asset the corporation did own in the exclusive service contract with Mr. Laughton, to keep his name and face before the public. This view of the facts was the one taken by the Board Member in his opinion. [R. 31.] On the other hand, there is no evidence upon which the assumption can be based that petitioner employed Industries, Ltd., as an intermediary. Petitioner goes on to state that:

> "In so far as the income involved in this proceeding was concerned, Industries, Ltd., was nothing more than the agency whereby taxpayer retained full

control and beneficial interest in the fruits of his personal services without receiving them."

Here again the evidence disclosed in the record is contrary to the conclusion made by petitioner. It was shown that Industries, Ltd., had as its board of directors business men who did not even consult Mr. Laughton with regard to company policy. Presumably the accrual of the income here involved to the corporation of which Mr. Laughton owned all the stock might increase the value of that stock. However, such fact does not give a foundation for stating that Mr. Laughton retained the beneficial interest in the fruits of his personal services since until he sold that stock and realized the increment thereto from the advantageous loan agreements made by the company, he himself realized beneficially no part of the earnings of the corporation. *Cf. Eisner v. Macomber,* 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521. One of the directors of the corporation has testified that because of its interest in improving its capital position, the corporation did not declare any dividends to Mr. Laughton. Once the capital position of the corporation was sufficiently large, production was commenced in conjunction with a subsidiary unit. [R. 29.] It engaged in the business purpose for which it was organized.

It is submitted, therefore, that the conclusions made by petitioner with regard to the facts in the case at bar are completely unwarranted and that the facts as they exist in the record before this Court do not merit disregard of the corporate entity of Industries, Ltd.

3. The Contention of Petitioner That the Corporate Entity of Industries, Ltd., Should be Disregarded and the Income Realized by It Declared Taxable to Mr. Laughton Is Contrary to the Law as Established by the Supreme Court and Followed in the Lower Courts.

As it was pointed out above, the case of *New Colonial Ice Co. v. Helvering,* decided by the United States Supreme Court, 292 U. S. 435, 54 Sup. Ct., 208, 78 L. Ed. 1348, is the leading authority in which the treatment of a corporate entity in the matter of federal taxation is discussed. The rule established in this case to the effect that the corporate entity may be disregarded only in exceptional situations has been followed in the following cases:

Burnet v. Commonwealth Improvement Co., 287 U. S. 415, 53 S. Ct. 198, 77 L. Ed. 399 (1932);

Burnet v. Clark, 287 U. S. 410, 53 S. Ct. 207, 77 L. Ed. 397 (1932);

Dalton v. Bowers, 287 U. S. 404, 53 S. Ct. 205, 77 L. Ed. 389 (1932);

Jones v. Helvering, 71 Fed. (2d) 214 (C. A. D. C. 1934);

Ford Motor Co. v. United States, 9 Fed. Supp. 590 (Ct. Cl. 1935);

Hunt v. Commissioner, 5 B. T. A. 356;

Consumers Construction Co. et al. v. Commissioner, 35 B. T. A. 966 (1937).

Furthermore, the rule stated above is not altered by the fact that one stockholder owns all the stock of the corporation where there is no evidence of fraud.

Wagner v. Lucas, 38 Fed. (2d) 391 (C. A. D. C. 1930);

Broadway Strand Theatre Co. v. Commissioner, 12 B. T. A. 1052 (1928);

International Building Co. v. Commissioner, 21 B. T. A. 617 (1930);

Greenwood v. Commissioner, 1 B. T. A. 291 (1925);

Fontaine Fox v. Commissioner, 37 B. T. A. 271 (1938).

This latter case, *Fontaine Fox v. Commissioner,* closely parallels the case at bar. What variation there does exist in the facts of these two cases, namely *Fontaine Fox v. Commissioner,* and the case at bar, indicates the more clearly the fact that the corporate entity of Industries, Ltd., should not be disregarded.

It appeared in the *Fox* case that Reynard Corporation which Mr. Fox organized, had no purpose other than to exploit the cartoons of Mr. Fox and the evidence showed that it engaged in no other business. In contrast, the corporation which respondent organized, was formed for a purpose other than to avail itself of the services of Mr. Laughton. It was to be and in fact was a corporation with a comprehensive business purpose in which it engaged, which it legitimately contemplated. Petitioner, however, did not see fit to appeal from the decision of the Board of Tax Appeals in favor of Mr. Fox, a fact which would indicate that he was satisfied that the Board of Tax Appeals had correctly interpreted the law.

Conclusion.

For the reason, therefore, that the cases relied upon by petitioner do not stand for legal propositions which support his contentions unless there be drawn inferences and conclusions from the facts of record in the case at bar which are completely unwarranted and for the most part expressly negatived by the evidence, by the findings of the Board and even by the conclusions of petitioner himself respecting denial of refund claims, and for the reason that the authorities herein analyzed and cited support the contentions of respondent herein, it is respectfully submitted that the decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted,

Claude I. Parker,
John B. Milliken,
Loyd Wright,
Herschel B. Green,
Harriet Geary,
Attorneys for Respondent.